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CANADIAN
Tricentrol
OILS LTD.

Name changed, 1972, to TRICENTROL Canada LTD, subsidiary of Trinidad Canadian Oils Ltd

1971

ANNUAL REPORT

To the Shareholders of

Canadian Tricentrol Oils Ltd.:

2640 - One Calgary Place, 330 - 5th Avenue S.W.
Calgary, Alberta, Canada T2P 0L4

During 1971 the pace of Canadian Tricentrol's exploration and development activity slowed somewhat, and continuing delays in obtaining governmental certificates and authorizations permitting the placing on-stream of Tiger Ridge Gas Field led to a further deferment of the Company's capital expenditure commitment in the State of Montana. The Company's reserves of Tiger Ridge natural gas are contracted to Northern Natural Gas Company, who are of the opinion that the U.S. Federal Power Commission and the National Energy Board of Canada will issue all necessary permits and authorizations permitting the installation of pipeline facilities before mid-1972. It is also anticipated that construction of these facilities will lead to initial deliveries of gas commencing in November, 1972.

Financial

The Company continued to receive monthly payments throughout 1971 under the "take-or-pay" clause of its gas purchase contract with Northern Natural and $1,697,344 has been recorded as current income in 1971 ($872,125 in 1970). Gross revenue from the sale of production increased 19% to $2,263,955 ($1,897,283 in 1970) due to a combination of improved prices for Western Canadian crude and increased production. In 1971 the Company recognized deferred income tax on extraordinary income that resulted from conversion of a development loan in the previous year, and 1970 net income has been restated to reflect a deferred income tax provision of $690,000. Net income for the year 1971 was $1,972,844, as compared to the restated net income of $1,804,610 for the previous year.

Production

Overall oil production from Canada and the U.S. increased 8% to 789,592 barrels from the 1970 total of 730,216 barrels, the bulk of which was obtained from producing properties in Western Canada (692,710 barrels 1971, 634,638 barrels 1970). Average daily gas volumes delivered increased 34% from 2,444 mcf to 3,273 mcf in 1971; 98% of the Company's gas production was derived from its Canadian properties.

Drilling Activity

The Company drilled or participated in 27 exploration and development wells in the Western Provinces of Canada resulting in 9 oilwells, 4 gaswells, and 14 dry holes. In the U.S., participation in the drilling of 15 wells resulted in 1 oilwell being completed in Wyoming and 4 gaswells in the Bearpaw area of Montana; the remaining 10 dry holes were all drilled in the State of Montana with the sole exception of an unsuccessful test well drilled in Wyoming. In addition, 20 wells were drilled at no cost to the Company on a farmout of its Sherard (Montana) acreage resulting in 6 gaswells. Further drilling of this area is planned for 1972. Consolidated footage drilled in 1971 was 85,351 and 12,616 gross and net feet respectively, in contrast to 282,470 and 60,994 gross and net feet drilled in year 1970.

Land

The Company's interest in 401,504 Canadian Arctic permit acres on Banks Island has been reduced from 25% to 3.75% following the fulfillment by Panarctic Oil Ltd. of its exploration commitment under its farmout agreement with the Company. At the close of 1971 Canadian Tricentrol held varying interests in lease and reservation acreage in Canada of 1,527,859 and 103,208 gross and net acres respectively, and in 617,176 gross acres and 305,272 net acres located in the U.S.

Corporate

On December 1, 1971, Tricentrol Oils Limited offered to acquire all the common shares of Canadian Tricentrol Oils Ltd. not then owned by it at the price of $15.00 per share. Pursuant to this offer, which expired December 23, 1971, Tricentrol Oils Limited acquired an additional 108,578 shares, and at December 31, 1971 beneficially owned 1,135,913 of the 1,148,355 issued and outstanding shares of Canadian Tricentrol. The offer of Tricentrol Oils Limited was renewed on February 1, 1972, and following expiry of the renewed offer on February 29, 1972 that company had increased its beneficial ownership to 1,140,720 shares, approximately 99⅓% of the issued and outstanding share capital of Canadian Tricentrol.

As a result of the aforesaid offer, the small number of publicly held shares of the Company were insufficient to maintain an orderly or representative market in the shares on a stock exchange, and accordingly, pursuant to the Company's request, the shares were delisted for trading on the Toronto, Calgary and Vancouver Stock Exchanges effective February 29, 1972.

Canadian Tricentrol Oils Ltd. is a sub-subsidiary of the United Kingdom company Tricentrol Limited (formerly known as Trinidad Canadian Oils Limited) and the Tricentrol group of companies have agreed upon an alignment of corporate names. Accompanying this report is Notice of an Annual and Special General Meeting to be held on April 28th, 1972 at which shareholders will be asked to approve a resolution to change the name of the Company to Tricentrol Canada Limited.

On December 31, 1971, Mr. Alexander G. Bailey resigned his position on the Board of Directors of the Company after more than two years of valuable and capable service. His place has been taken by Mr. Arthur P. Haines, who has served the Company in a variety of adminstrative positions for a number of years.

On Behalf of the Board of Directors

J. G. S. LONGCROFT

March 29, 1972. President

CANADIAN TRICENTROL OILS LTD.

And Its Wholly-Owned Subsidiaries

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For The Year Ended December 31, 1971

(with 1970 figures for comparison)

	1971	1970
INCOME:		
Sale of crude oil and natural gas	$2,247,966	$1,885,986
Royalty income	15,989	11,297
Total income	2,263,955	1,897,283
OPERATING EXPENSES:		
Production and royalty expense	945,036	888,092
INCOME FROM PRODUCTION	1,318,919	1,009,191
OTHER INCOME:		
Sale of an interest in the proceeds of future gas sales, less related costs, resulting from gas purchase contract (Notes 3, 4 and 5)	1,697,344	872,125
Interest income	16,287	7,839
Miscellaneous	22,392	8,255
Total other income	1,736,023	888,219
INCOME BEFORE EXPENSES	3,054,942	1,897,410
EXPENSES:		
General and administrative	325,867	243,689
Interest	179,914	218,126
Total expenses	505,781	461,815
INCOME BEFORE DEPLETION AND DEPRECIATION	2,549,161	1,435,595
PROVISION FOR DEPLETION AND DEPRECIATION	479,810	411,391
INCOME FOR THE YEAR BEFORE EXTRAORDINARY ITEMS ($1.80 and $.89 per share)	2,069,351	1,024,204
EXTRAORDINARY ITEMS:		
Sale of an interest in the proceeds of future gas sales, less related costs, resulting from conversion of a development loan — net of deferred income taxes (Notes 3, 4, 5, and 11)	—	673,006
Excess consideration over asset values acquired	(19,718)	—
Gain on foreign exchange	16,444	107,400
Net extraordinary items	(3,274)	780,406
INCOME FOR THE YEAR BEFORE PROVISION FOR INCOME TAXES	2,066,077	1,804,610
PROVISION FOR INCOME TAXES (Note 6)	93,233	—
NET INCOME FOR THE YEAR ($1.72 and $1.57 per share)	1,972,844	1,804,610
RETAINED EARNINGS AT BEGINNING OF THE YEAR:		
As previously reported	4,584,364	2,089,754
Adjustment of prior year's deferred income taxes (Note 11)	690,000	—
As restated	3,894,364	2,089,754
RETAINED EARNINGS AT END OF THE YEAR	$5,867,208	$3,894,364

The accompanying notes are an integral part of the financial statements.

CANADIAN TRICENTROL OILS LTD.
And Its Wholly-Owned Subsidiaries

ASSETS

	1971	1970
CURRENT ASSETS:		
Cash	$ 355,583	$ 164,978
Accounts receivable:		
Production and joint operations	659,350	528,240
Other	26,141	47,133
Parent company	23,065	23,430
Crude oil inventory — at posted field price	50,461	50,058
Prepaid expenses	47,195	62,547
Total current assets	1,161,795	876,386
DEPOSITS AND NOTE RECEIVABLE — at cost (market value 1971 — $129,618; 1970 — $199,690)	130,852	201,771
PROPERTIES AND EQUIPMENT — at cost (Note 2):		
Developed lease and royalty interests	9,339,048	8,457,998
Production and lease equipment	2,712,441	2,682,266
Undeveloped and non-producing properties	3,693,908	3,792,581
	15,745,397	14,932,845
Less accumulated depletion and depreciation (Note 4)	3,734,885	3,735,645
Net properties and equipment	12,010,512	11,197,200
INCORPORATION EXPENSE — at cost	—	606
TOTAL	$13,303,159	$12,275,963

Approved by the Board:

J. G. S. LONGCROFT, Director

R. P. ALGER, Director

CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1971

(with 1970 figures for comparison)

LIABILITIES AND SHAREHOLDERS' EQUITY

	1971	1970
CURRENT LIABILITIES:		
Bank loan payments due within one year, repayable $600,000 in Canadian funds and $360,000 U.S. funds	$ 958,481	$ 964,163
Accounts payable and accrued liabilities	306,327	391,479
Income taxes payable	78,170	—
Due to parent company	25,730	25,730
Total current liabilities	1,368,708	1,381,372
LONG-TERM DEBT:		
Bank loans secured by the hypothecation of certain producing properties and/or the proceeds therefrom, repayable in $1,410,000 Canadian funds, $720,886 U.S. funds — less included in current liabilities	1,188,179	1,945,129
Prepayment on future gas deliveries	54,417	46,250
Non-interest-bearing advances from parent company, no fixed terms of repayment	390,787	910,890
Total long-term debt	1,633,383	2,902,269
ESTIMATED PRODUCTION COSTS AND ROYALTIES PAYABLE (Note 4)	851,520	515,618
DEFERRED INCOME TAXES (Note 11)	690,000	690,000
SHAREHOLDERS' EQUITY:		
Capital stock:		
Authorized:		
1,250,000 common shares of a par value of $2 each		
Issued and fully paid — 1,148,355 shares	2,296,710	2,296,710
Contributed surplus (Note 10)	595,630	595,630
Retained earnings	5,867,208	3,894,364
Total shareholders' equity	8,759,548	6,786,704
TOTAL	$13,303,159	$12,275,963

The accompanying notes are an integral part of the financial statements.

CANADIAN TRICENTROL OILS LTD.

And Its Wholly-Owned Subsidiaries

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

For The Year Ended December 31, 1971
(with 1970 figures for comparison)

	1971	1970
FUNDS PROVIDED:		
Net income for the year	$1,972,844	$1,804,610
Depletion and depreciation	880,288	889,092
Estimated production costs and royalties	335,902	515,618
Deferred income taxes	—	690,000
Advance to former subsidiary written off	502	—
Total funds provided from operations	3,189,536	3,899,320
Bank loans	—	2,071,126
Proceeds from development loan	—	166,327
Prepayment under gas purchase contract	8,169	—
Proceeds from sale of investment	536	—
Proceeds from sale of property and equipment	12,945	23,070
Collection of advances and deposits	63,204	55,250
Total funds provided	3,274,390	6,215,093
FUNDS APPLIED:		
Additions to properties and equipment:		
Acquisition of properties	432,528	624,819
Exploration and development	864,691	923,068
Production and lease equipment	95,726	103,867
Undeveloped lease rental expense	293,237	313,172
Leasehold improvements	10,681	—
Total additions to properties and equipment	1,696,863	1,964,926
Repayment of bank loans	756,950	1,862,003
Repayment of advances from parent company	520,103	204,000
Increase in deposits and note receivable	2,401	33,717
Conversion of a development loan into a production payment (Notes 3 and 5)	—	2,141,709
Total funds applied	2,976,317	6,206,355
INCREASE IN WORKING CAPITAL FOR THE YEAR	298,073	8,738
DEFICIENCY IN WORKING CAPITAL AT BEGINNING OF THE YEAR	504,986	513,724
DEFICIENCY IN WORKING CAPITIAL AT END OF THE YEAR	$ 206,913	$ 504,986

The accompanying notes are an integral part of the financial statements.

CANADIAN TRICENTROL OILS LTD.

And Its Wholly-Owned Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1971

1. PRINCIPLES OF CONSOLIDATION:

The accounts of High Crest Oils, Inc., a wholly-owned United States subsidiary company, and Gerla Petroleums Limited are included in the consolidated financial statements. The accounts of the United States subsidiary were converted; (a) as to current assets and current liabilities, at the rate of exchange prevailing at December 31, 1971 and (b) as to properties and equipment, long-term debt, and capital stock, at historical rates and (c) as to income and expenses (except depletion and depreciation), at the approximate average rate for the month in which the transactions occurred, and as to depletion and depreciation, at the exchange rates applicable to the related properties and equipment.

2. ACCOUNTING PRACTICES:

The companies follow the full-cost method of accounting wherein all costs relative to the exploration for and the development of oil, gas and related reserves are capitalized. Such costs include acquisition costs, geological and geophysical expense, carrying charges of non-producing properties, costs of drilling both productive and unproductive wells, production equipment and gas facilities, mineral exploration costs, and all technical and administrative overhead directly associated with these functions. Proceeds received from disposal of properties are deducted from net asset costs without recognition of profit or loss. These net costs, together with an estimate of the company's share of anticipated costs to place certain gas properties in condition to deliver the gas called for by a gas purchase contract, are amortized on the composite unit of production method based on total estimated recoverable reserves.

3. GAS PURCHASE CONTRACT AND PRODUCTION PAYMENT AGREEMENT:

Under a gas purchase contract signed in 1969, a subsidiary company has received funds which relate to the sale of an interest in the proceeds of future gas sales. The contract extends for a period of twenty years following commencement of delivery of gas, subject to termination by the purchaser on sixty days notice and, following the twenty-year period, from year to year, subject to one year's notice of termination by either party. After December 31, 1971, in certain circumstances, the subsidiary company may terminate the contract by giving six months notice. Under certain conditions, the purchaser is committed to continue payments to the company for one year following the date of termination.

If delivery of gas is made to the purchaser, or to any other party, a portion of the proceeds resulting from the delivery is to be paid to the purchaser. Payment is at the rate of 33⅓% of proceeds if delivery is made to the purchaser, and 25% of ⅞'s if to any other party. The upper limit of such payments is the amount advanced prior to commencement of delivery under the gas purchase contract (U.S. $3,966,758 at December 31, 1971) and the converted development loan mentioned below (U.S. $1,993,971 at December 31, 1970).

In November 1970, the subsidiary company exercised its option under a development loan agreement to convert the loan into a production payment agreement, and thereby sold an interest in the proceeds of future gas sales.

Under both the gas purchase contract and the production payment agreement, there is no obligation on the part of the company to repay the funds received should production not commence. Upon commencement of production and delivery, the operation of the gas purchase contract parallels that usually associated with "take-or-pay" agreements.

4. OTHER INCOME AND EXTRAORDINARY INCOME:

(a) Provision has been made, as follows, for costs relating to the sales of an interest in the proceeds of future gas sales:

	1971	1970	
	Gas Purchase Contract	Gas Purchase Contract	Conversion of Development Loan
NET RECEIPTS	$2,433,724	$1,262,552	$1,965,898
RELATED COSTS:			
Production costs and royalties	335,902	201,436	314,182
Depletion and depreciation	400,478	188,991	288,710
	736,380	390,427	602,892
PROVISION FOR DEFERRED TAXES (Note 11)	—	—	690,000
TOTAL RELATED COSTS AND DEFERRED TAXES	736,380	390,427	1,292,892
OTHER INCOME	$1,697,344	$ 872,125	
EXTRAORDINARY INCOME (as restated)			$ 673,006

The production costs and royalties provided for are shown in the balance sheet as "Estimated Production Costs and Royalties Payable", and the amounts shown for depletion and depreciation have been included in "Accumulated Depletion and Depreciation".

(b) Although the company has elected to account for receipts under the gas purchase contract and production payment agreement on the basis set out above, an alternative accounting treatment as recommended by a Research Study on Financial Reporting in the Extractive Industries sponsored by the American Institute of Certified Public Accountants would result in the receipts being treated as deferred income and the following changes in these financial statements:

In the Statement of Income:

Other income and income for the year before extraordinary items would be reduced by $1,697,344 (1970 - $872,125).

Net income for the year would be reduced by $1,697,344 (1970 - $2,235,131 before deferred tax provision and $1,545,131 after deferred tax provision).

In the Balance Sheet:

Accumulated depletion and depreciation would be reduced by $878,179 (1970 - $477,701).

Deferred Income tax payable of $690,000 would be eliminated in both years.

Estimated Production Costs and Royalties Payable of $851,520 would be eliminated (1970 - $515,618).

Retained Earnings would be reduced by $3,242,475.

Deferred Income of $5,662,174 would be shown.

In the Statement of Source and Application of Funds:

Total funds provided from operations would be reduced by $2,433,724 (1970 - $3,228,450), and a like amount shown as funds provided through receipts under a production payment agreement and a gas purchase contract. There would be no change in the total funds provided.

5. NATURE OF NET RECEIPTS FROM PRODUCTION PAYMENT AGREEMENT AND GAS PURCHASE CONTRACT:

As stated previously, after initial delivery to the purchaser commences, the company has no liability in connection with the development loans (now converted to a production payment) or the receipts under the gas purchase contract, excepting only to supply appropriate quantities of gas in the future. There being no dollar liability involved, the funds received in this connection belong to the shareholders, and must find their way into the shareholders' equity section of

the balance sheet. To do this, they must be reflected as income, and this the company has done. The company believes that to reflect these receipts as deferred income would be misleading to shareholders and other interested parties. The amounts are material, the nature of the amounts received is clear, and to reflect them other than as they are would be improper. Therefore, in these circumstances, the company believes the amounts involved to be properly reflected as income, despite the adverse view of the company's auditors.

6. INCOME TAXES:

No material federal income taxes are payable by the company or its Canadian and United States subsidiaries for 1971, since development expenditure and depletion allowances which may be claimed under the respective Income Tax Acts are in excess of those shown in the accounts of the companies and tax losses determined in prior years are being utilized. Subject to any changes which may arise upon assessment of the companies' tax returns, approximately $2,743,000 of unclaimed expenditures or loss-carry-forward remained at December 31, 1971. The company has provided $93,233 for state license (income) taxes.

The company does not consider it appropriate to provide for income taxes deferred as a result of claiming for income tax purposes drilling, exploration and lease acquisition costs, in excess of the related charges to earnings, and this view conforms to general practice in the oil and gas industry.

These practices differ from the tax allocation recommendation of the Canadian Institute of Chartered Accountants that income tax be provided for on the basis of income reported in the accounts. If the tax allocation basis had been followed for all timing differences between taxable income and reported income, deferred income taxes of $182,000 (1970 - $1,094,163) would have been provided, and net earnings for the year would have been reduced accordingly. The accumulated deferred income tax provisions covering the current and prior years would have amounted to $2,790,000 of which $690,000 has been provided (Note 11).

7. REMUNERATION OF MANAGEMENT AND OTHERS:

Directors' fees aggregating $6,240 were paid to two directors of the company during 1971 (1970 - $3,757). Until April 30, 1971 the company had no employees, general administrative management services being provided under various agreements for which management companies were paid $116,544 (1970 - $263,276). Included in this amount was $23,388 (1970 - $120,828) paid to the companies' technical managers for services in connection with property acquisition exploration and development which has been capitalized in accordance with the companies' accounting practice. The balance of $93,156 (1970 - $142,448) is included in general and administrative expenses.

These agreements were terminated April 30, 1971, and during the remainder of the year remuneration of $63,840 was paid directly to senior officers of the company.

8. MANAGEMENT CONTRACTS:

Effective May 1, 1971 all existing management contracts were terminated, except for royalty and reversionary interest earned, and superseded by a management agreement under which the companies are now contractually liable for a period of eight years for:

(a) a fee of $50,000 per annum, together with all reimbursable costs;

(b) an assignment of a gross overriding royalty interest equal to 2½% on all property interests acquired after April 30, 1971.

Under these management arrangements senior executive management is provided by the management company, and the companies bear the cost of certain technical and administrative personnel previously borne by the management company.

9. LITIGATION:

On August 5, 1971 a Statement of Claim was served on the company and its subsidiary by a former corporate employee of a management company previously engaged to provide technical management services. The Plaintiff is claiming certain additional working interests in properties jointly owned with the companies, and general damages of $100,000. The companies have admitted no liability in these matters and have filed a Statement of Defence. No provision has been made to cover the possibility of payment or settlement of these claims, as in the opinion of counsel the claims are not well founded and should not succeed.

10. CONTRIBUTED SURPLUS:

Amounts received by the company in excess of the par value of issued capital stock have been credited to contributed surplus. The account has been reduced in prior years by deficits written off in the course of company reorganization and an appropriation to recognize non-recoverable costs of developed properties and surrender or disposal of undeveloped properties. There were no changes during 1971 or 1970.

11. CHANGE IN ACCOUNTING PRACTICE:

During the year the company recognized deferred income tax on the sale of an interest in the proceeds of future gas sales resulting from conversion of a development loan. This extraordinary income was received in 1970 and accordingly net income for that year and retained earnings at December 31, 1970 have been restated to reflect a deferred income tax provision of $690,000.

AUDITORS' REPORT

To the Shareholders of
Canadian Tricentrol Oils Ltd.:

We have examined the consolidated balance sheet of Canadian Tricentrol Oils Ltd. and its wholly-owned subsidiaries as at December 31, 1971 and the consolidated statements of income and retained earnings and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of the accounting records and other supporting evidence as we considered necessary in the circumstances.

During the current year, as outlined in Notes 3 and 4, a subsidiary company has received funds under a gas purchase contract, which funds have been included in other income, and in 1970 converted a development loan, mostly received in a prior year, into a production payment which was included in extraordinary income in that year, in both cases after providing for applicable costs. Although the practice of recognizing such receipts as income when received has been followed by some companies, in our opinion this accounting practice is not in accordance with generally accepted accounting principles in North America. The prevalent practice is to record receipt of such amounts as deferred income, and to recognize these amounts as income when the gas is produced and delivered, which practice, if adopted, would result in the changes set out in Note 4 (b) to the financial statements.

Although full disclosure of the relevant facts has been made in the financial statements and notes thereto, the effect of the accounting practice chosen by the company is sufficiently material that we must offer an "adverse opinion" as that term is used in recommendations of the Accounting and Auditing Research Committee of the Canadian Institute of Chartered Accountants. Accordingly, in our opinion, the accompanying consolidated financial statements, taken as a whole, do not present fairly the financial position of the company and its wholly-owned subsidiaries as at December 31, 1971 and the results of their operations and the sources and applications of their funds for the year then ended, in accordance with generally accepted accounting principles.

In our opinion, however, in all material respects, the assets, apart from the reduction of $878,179 in "Net properties and equipment", and the liabilities, apart from the inclusion of "Estimated Production Costs and Royalties Payable" and the omission of Deferred Income of $5,662,174, are presented fairly in the balance sheet; income, operating expenses, expenses, provision for depletion and depreciation, gain on foreign exchange and provision for income taxes are presented fairly in the statement of income; and the items, other than those mentioned in Note 4 (b), are presented fairly in the statement of source and application of funds, all in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year after restatement of the 1970 financial statements for deferred income tax as explained in Note 11.

Calgary, Alberta
March 29, 1972.

DELOITTE, HASKINS & SELLS
Chartered Accountants

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